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SUBJECT: POPULAR PARTY FORESEES ECONOMIC CHALLENGES AHEAD  
FOR SPAIN

Classified By: Economic Counselor Whitney Baird for reasons 1.4 (b) and (d).

1. (C) Summary: The opposition Popular Party's Economic Spokesperson in Parliament Miguel Arias Canete predicted 2005 would be a good year for Spain, but that beginning in 2006 Spain's economy would sour and imperil Spain's Socialist government. He declared strong respect for Minister of Economy and Finance Pedro Solbes and the economic team, but noted that Solbes faces strong challenges in shepherding Spain's budget and economy in a cabinet of more radical political heavyweights. Arias Canete expressed sympathy with respect to our biotech position, noting that he was a strong proponent of biotechnology during his previous position as Minister of Agriculture. He offered assistance with biotech issues with Spanish deputies in the European Parliament. End Summary.

#### Economic Outlook

2. (U) Arias Canete characterized Spain's 2005 economic outlook as solid. He stated that the fiscal environment of stable spending growth and balanced budget was a gift to the Socialists (PSOE) from the previous Popular Party (PP) government. However, he noted Spain's inflation rate of about 1.3 percent higher than the EU average as an area of concern. He also noted that since Spain was an EU member and EU monetary policy was predicated on the sluggish German economy, Spain would not be able to use monetary policy to curb its inflation. Cheap interest rates have contributed to the steep rise in Spanish housing prices in the past few years.

3. (C) According to PP economic projections, although the outlook for 2005 is "solid", Spain's economy will slow significantly in 2006. Arias Canete believes a recession is probable and that the PSOE government will be forced to call early elections due to the resulting economic stress.

#### Minister Solbes and the Economic Team

4. (U) Arias Canete offered high praise for PSOE Minister of Economy and Finance Pedro Solbes. He noted Solbes' personal professional stature as a guardian of the European Monetary Union treaties in Brussels and for bringing France and Germany to court for breaking budget deficit rules. Arias Canete believes Solbes, with his EU experience, is truly committed to ensuring budgetary stability during his tenure.

5. (C) He was less certain, however, whether Minister Solbes would be able to maintain the support of President Zapatero and keep future efforts at increasing spending in line with his budgetary standards. According to Arias Canete's sources, Solbes is regularly opposed by the President's economic policy advisor Miguel Sebastian. Sebastian regularly announces new economic policy changes without Solbes' comment. Solbes also faces challenges in Zapatero's Cabinet. In the Spanish system, there are multiple cabinet levels. The first meeting each week the Secretary of State's meeting (note: equivalent to Deputies' Committee). According to Arias Canete, Miguel Angel Fernandez Ordonez, the Secretary of State for Economy and Budget is often

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outmaneuvered by Economic Advisor Miguel Sebastian at these meetings. Minister Solbes is then forced to try to overcome the decision of the Secretaries of State in the Council of Ministers. Arias Canete is not sure Solbes will continue to prevail in these battles, or that he will want to keep fighting if the economy sours.

6. (C) Regarding rumors that Solbes might not finish his entire term, Arias Canete noted that Solbes is a man of his word and that he is likely to keep his promise and serve throughout this government. However, if in future budgets the government pushes spending to a deficit level beyond 3 percent, breaking the EMU standards, Mr. Solbes might

consider resignation. Arias Canete noted (somewhat jokingly) that he would do everything he could to push Solbes out of office, because any PSOE replacement would be a much easier political target for the PP.

#### Economic Reform on Hold

17. (C) Arias Canete mentioned several areas where economic reform was necessary, but is convinced that the Socialist government is unable or unwilling to carry through. The key area for reform is the labor market. Arias Canete argued that the link between inflation and wages in Spain without any correlation to productivity needs to be broken. He also mentioned the need to improve competition in the marketplace, especially in telecoms and energy. Though the economic team may well support many of these changes, Arias Canete does not believe they will get much traction in the current government. He noted that most of the PSOE ministers are far more left-wing in their economic philosophy than the economic team and that President Zapatero is not a strong leader, but a compromiser unwilling to push a policy unpopular in his own party.

#### Biotech

18. (U) Arias Canete sympathized with the U.S. position on biotech issues. He mentioned that he approved several seed varieties during his tenure as Minister of Agriculture. He also noted that he is being taken to court along with the succeeding PP Minister of Agriculture for approving biotech strains that could allegedly threaten the environment. Arias Canete believes that biotech crops are very important for Spain, noting that new strains of cotton are greatly desired by farmers in the south. He asked us to inform him of any biotech legislation of importance that passes through the European Parliament. He is willing to assist us by lobbying PP members in the European Parliament.

#### Comment

19. (C) Arias Canete is clearly interested in maintaining close ties with the United States. He is a well-informed, articulate spokesperson for PP policies. He provided us with a number of concise, cogent PP position papers on economic issues. They show this group is serious, and views itself as only temporarily in opposition.  
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